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**COMMONWEALTH OF VIRGINIA, ex rel.**

**STATE CORPORATION COMMISSION**

**v.**

**CASE NO. PUE980628**

**AUBON WATER COMPANY,**

**Defendant**

**SECOND SETTLEMENT PROGRESS REPORT**

**December 8, 2000**

On December 16, 1998, the Commission entered an Order of Settlement against Aubon Water Company (“Aubon”). The Order required Aubon to construct a water treatment facility to serve the Long Island Estates subdivision located on Smith Mountain Lake in Franklin County, Virginia. The Order provided that the Commission would retain jurisdiction over the matter until further order.

In a companion case, Case No. PUE990002, the Commission approved a rate increase which included revenues designed to recover the cost of constructing the water treatment facility. The Commission required Aubon to establish an escrow account to be used solely for the payment of expenses related to the construction, operation, and maintenance of the facility. The Commission further required Aubon to deposit into that escrow account the additional revenues it approved to pay off a ten-year loan, which Aubon had not yet obtained, for construction of the facility. If Aubon failed to obtain financing within eight months of the effective date of the Commission’s Final Order, Aubon was ordered to: (1) file an application for a rate decrease that eliminated the revenues associated with the water treatment facility; and (2) place into effect the individual rates recommended by the Staff in the case, on an interim basis.

As set forth in greater detail in the Settlement Progress Report entered by this Hearing Examiner on May 1, 2000, Aubon was unable to obtain construction financing for the water treatment facility from its bank. Financing was denied in part because the Town of Rocky Mount annexed a portion of Franklin County that included Aubon’s Franklin Heights water system. As part of the annexation, the Town of Rocky Mount agreed to provide municipal water and sewer service to the areas it annexed, including the Franklin Heights subdivision. Aubon’s bank refused to loan it any money for the construction of the facility until it resolved the issue of the possible loss of revenue from its Franklin Heights water system.

By Order entered on May 26, 2000, the Commission extended the date by which Aubon must secure financing for the construction of the water treatment facility to December 31, 2000.

On July 27, 2000, Aubon was notified that it again failed to qualify for construction financing under Virginia’s Drinking Water State Revolving Fund Program, which is administered by the Virginia Department of Health (“VDH”). Approximately one week later,

the VDH issued a Special Order finding Aubon in violation of Virginia's Waterworks Regulation, 12 VAC 5-590-10 through 1280, and directing Aubon to take specific action to bring the company back into compliance with the regulations. Aubon was given until November 15, 2000, to comply with the order. If Aubon failed to comply with the order by that date, VDH threatened to pursue one of the following courses of action: (1) petition the Commission to appoint a receiver to operate the company pursuant to § 56-265.13:6.1 of the Code of Virginia; (2) refer the case to the Commonwealth's Attorney in Franklin County for criminal prosecution pursuant to § 32.1-27 (A) of the Code of Virginia; or (3) refer the case to the Office of the Attorney General to file a civil lawsuit in Circuit Court seeking penalties, pursuant to § 32.1-176, of up to \$5,000 for each day the company continues to violate the Waterworks Regulation.

On September 18, 2000, the Hearing Examiner scheduled a hearing for November 6, 2000, for the purpose of receiving evidence on whether there was any possibility the water treatment facility could be constructed, or whether Aubon should be released from the requirements of the Commission's Order of Settlement, ordered to decrease its rates to the level recommended by the Staff in the company's last rate case, ordered to pay all remaining bills related to the water treatment facility, and ordered to refund to its customers any amounts remaining in the escrow account.

The hearing was convened as scheduled on November 6, 2000. G. Ray Boone, president of Aubon Water company appeared on behalf of the company. The Staff appeared by its counsel Don R. Mueller, Esquire. Petrus Environmental Services, Inc. ("Petrus Environmental") appeared by its counsel Michael S. Ferguson, Esquire. Two public witnesses appeared at the hearing.

Two key issues were addressed at the hearing. The first involved the approval of the final plans and specifications for the water treatment facility. A representative of the Department of Health, Office of Water Programs ("VDH-OWP") testified his office received everything it needed from Aubon to consider approval of the final plans and specifications. The second issue involved the possible purchase of Aubon by Petrus Environmental Services, Inc. Mr. David Petrus testified his company entered into an Intent Agreement with Aubon to purchase the water company. Mr. Petrus testified he was in the process of negotiating the terms of a possible sale of the Franklin Heights water system to the Town of Rocky Mount, or some other arrangement that would provide sufficient revenues to make the purchase of Aubon financially viable.

The sale of the water company to Petrus Environmental probably represents the last chance for the homeowners in Long Island Estates to have a water treatment facility built to serve their subdivision. Aubon is financially incapable of completing the project or complying with the Commission's Order of Settlement. Petrus Environmental, however, has sufficient working capital to construct the water treatment facility without borrowing funds.

## **Discussion**

For a number of reasons, this has been an extremely frustrating case. Nearly everyone is in agreement that Aubon has supplied the residents of Long Island Estates with water that is

inferior in quality for far too long, but: What can be done? Aubon does not have the internal working capital, or access to financing necessary to construct the water treatment facility. The annexation of the Franklin Heights subdivision by the Town of Rocky Mount (the "Town") effectively cut off any hope for Aubon to borrow money from a commercial lender. Aubon's bank refused to loan it the money for the water treatment facility until the Town either agreed to pay Aubon an amount equal to the amount of the loan for the company's Franklin Heights water system, or the Town agreed that the company could continue to operate its Franklin Heights water system for the life of the loan. Franklin Heights represents more than 50 percent of the company's revenue stream. Without these revenues, Aubon does not have the ability to repay the construction loan needed to build the facility. Aubon does not have the financial resources to defend its Commission-issued Certificate of Authority from impairment by the Town, nor does it have the financial resources to defend its property right from an unconstitutional taking by the Town.

Petrus Environmental, a regional water company operator, came forward and agreed to purchase Aubon and construct the water treatment facility. However, Petrus Environmental conditioned the purchase on its ability to reach favorable terms with the Town regarding the Franklin Heights water system. Recent negotiations with the Town have been cause for little optimism. The Town initially offered Petrus Environmental \$25,000 for the Franklin Heights water system. Petrus Environmental has made a counteroffer. However, it has stated to the Staff that, unless it can reach an agreement with the Town where it is paid at least \$100,000 for the Franklin Heights water system, it will not pursue purchasing Aubon.

The VDH cannot be considered as a source of possible financing for the water treatment facility. Aubon's application for funds from the Virginia Drinking Water State Revolving Fund Program has been twice denied.

Although the prospects that the water treatment facility may be built are slim, I believe it is incumbent upon the Commission to provide the parties every opportunity to reach an agreement, or not. At present, Aubon must obtain financing by December 31, 2000, or it must file an application for a rate decrease, and place rates recommended by the Staff in the Company's last rate case into effect on an interim basis. With negotiations ongoing between Petrus Environmental and the Town, **I RECOMMEND** that the Commission extend its deadline for Aubon to obtain financing for the water treatment facility to March 1, 2001. In addition, Aubon's consulting engineers have continued to provide services to the company since February 2000, without having been paid. Therefore, **I FURTHER RECOMMEND** that the Commission authorize Aubon to disburse funds from its escrow account to bring its account with Spectrum Design current.

### **Comments**

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within seven (7) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to

the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

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Michael D. Thomas  
Hearing Examiner